IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 340 of 1983

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.

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1. Whether Reporters of Local Papers may be allowed to see the judgements?

2. To be referred to the Reporter or not?

3. Whether Their Lordships wish to see the fair copy of the judgement?

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?

5. Whether it is to be circulated to the Civil Judge?

RAVINDRA INDUSTRIES

Versus

COMMISSIONER OF INCOME-TAX

Appearance:
MR. D.A. MEHTA, MR. R.K. PATEL AND MR. B.D. KARIA,
Advocates for MR KC PATEL for Petitioner
MR. M.J. THAKORE, Advocate MR MANISH R BHATT for Respondent No. 1

CORAM : MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.
Date of decision: 09/12/96

ORAL JUDGEMENT (Per Rajesh Balia,J.)

At the instance of the assessee, the Income Tax Appellate Tribunal, Ahmedabad Bench "C" has referred the following two questions, said to be arising out of its appellate order in ITA No. 2120/Ahd/81 for assessment year 1976-77, for our opinion

1. "Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in interpreting the deed of partnership in question correctly and in holding that Shri H.N.Shah, retiring partner had to ask for and received profits, if any for 3 months during the period when he was partner in the assessee firm?"

2. "Whether, the Tribunal was justified in law in upholding the order passed u/s 263 of the Act especially when the factum of understanding between the partners as to withdrawal of credit balance only on retirement was never challenged by the Revenue?"

From the perusal of the order of the Tribunal and the CIT, we are of the opinion that the question suggested by the assessee and referred to us by the Tribunal do not bring out the controversy in its proper perspective and requires reframing and that in our opinion, the only question that arose out of the Tribunal's order is:

"Whether in the facts and circumstances of the case the Tribunal was justified in law in affirming the decision of the CIT for cancelling the order of registration granted in favour of the petitioner firm by the ITO and directing to give effect to the same?"

The assessee originally constituted of three partners was a registered firm for the purposes of Income Tax Act. During the previous year relevant for the assessment year 76-77 one of the partners Shri H.N.Shah, retired on 31.3.1975 and the remaining two partners continued to carry on the business of the firm without dissolution of the same - that is to say, the assessee firm continued to exist in a reconstituted form. As per the requirement of Section 184 of the I.T Act, as it stood at the relevant time, assessee made an application in form 11A in terms of Section 184(8) of the Act. By the order dated 10.9.1979, the Income Tax Officer held that there was a change in the partnership deed, form 11A together with partnership deed and duplicate thereof was filed, and the new partnership deed is executed on 13.5.75 and the firm is genuine. On the findings about procedural compliance and satisfying himself about the genuineness of the firm and the change in the constitution of the firm, registration was granted to the firm for the assessment year 76-77 as well by the I.T.O.

The assessment of the newly constituted firm was made by apportioning the profit of the firm for the calendar year 1975. The firm was having calendar year as its accounting period. The allocation of the entire profit of the calendar year was made between two existing partners as on the date of the end of the previous year, presumably relying on the principle laid down by the Supreme Court in CIT Vs Ashokbhai Chimanbhai - 56 ITR 42, holding that the right to receive the share in the profit for the year arises on the settlement of the account of the firm at the end of accounting period.

The Commissioner of Income Tax holding the opinion that the Income Tax Officer instead of allocating the income of the firm for the first period i.e. from 1.1.75 to 31.3.75 amongst three partners and the income for the remaining period between two partners according to respective partnership deeds, allocated entire income of the firm for whole year only between Shri P.R.Shah and Shri N.M.Sindhe equally. Since the income of the assessee firm was not properly allocated and distributed, the Income Tax officer should not have granted registration. Granting of registration under the circumstances narrated above has not only resulted in an erroneous order but is also prejudicial to the interest of the Revenue. On this basis after issuing show cause notice to the firm, it made order cancelling the registration of the firm on 27th August, 1981. On appeal the Tribunal affirmed the conclusion of the Commissioner and upheld the order under Section 263 cancelling the registration and directing the Income Tax Officer to give effect to that order accordingly. The Tribunal found that on 31.3.1975 there was a change in the constitution of the firm inasmuch as one of the Partners Shri H.N.Shah retired from the firm leaving behind two partners namely Shri P.R Shah and Shri N.M.Sindhe. Both the partners had equal share in the profits and loss of the assessee-firm and equal share was distributed for the whole year. Nothing was given to the retired partner i.e. Shri H.N.Shah. On these premises the Tribunal further concluded "to sum up the case, the condition for registration is that the profits should be distributed as provided in the deed of partnership. The same condition has not been fulfilled in the case. Therefore, in our opinion the Commissioner of Income Tax has rightly cancelled the order of the I.T.O and he was fully justified in directing the I.T.O to give effect to his order." In coming to the conclusion that requirement of allotment of share to the partners including to the retired partners at the close of the accounting period, it distinguished the Supreme Court decision in CIT Vs.

Ashokbhai Chimanbhai (supra) on the ground that there was no agreement between the retiring partner and the remaining partners about non-allotment of the shares upto the date of retirement and also on the ground that facts of the decision in Ashok Chimanbhai's case were different and the ratio was laid down in different context.

It has been contended before us by the learned Counsel for the assessee that apart from the question about entitlement to a share in the profit of the firm which can be ascertained only at the close of the accounting period in the case of a continued business by the reconstituted firm, there is no entitlement to share in the profit to retired partner unless there is agreement to the contrary because share itself cannot be determined and known unless accounts are settled and profits are known on the last date of the accounting period and because there is no day to day accruel of the profit. CIT as well as Tribunal has erred in ignoring the relevant provisions of the statute, inasmuch as apportionment of share of the profit amongst partners or amongst those who are entitled to it at the close of the year as such has no relevant bearing on the question of registration of the firm. The exercise of apportionment apart of the procedure of assessment of the income chargeable to tax in the hands of firm if the assessment has been of any error, in the formation of assessment, it does not render order granting registration erroneous and prejudicial to interest of Revenue. The error in assessment order, even if assumed to be there, cannot render registration of the firm liable to be cancelled on that ground. In that eventuality, at best the Commissioner could have exercised his jurisdiction to correct the error that has crept in assessment, but he could not have altered the status of the firm as a registered firm, which has been validly granted and for which no ground is made out for holding that to be erroneous.

Under the Income Tax Act, a firm, which is not a jurisdic person and have entity independent of its partners under the general law of partners, is an independent unit of assessment independent from the partners who constitute it and special procedure for the assessment of the income of the firm has been made. Chapter XVI of the I.T Act enacts special provisions applicable to firms. Under Section 182 and 183 it envisages that assessment of firm may be either as a registered firm or as an unregistered firm. Section 184 as it read at the relevant time, is reproduced hereinbelow:-

"184.(1) An application for registration of a firm for the purposes of this Act may be made to the Income-tax Officer on behalf of any firm if--

(i) the partnership is evidenced by an instrument; and

(ii) the individual shares of the partners are specified in that instrument.

(2) Such application may, subject to the provisions of this section, be made either during the existence of the firm or after its dissolution.

(3) The application shall be made to the Income-tax Officer having jurisdiction to assess the firm, and shall be signed --

(a) by all the partners (not being minors) personally; or

(b) in the case of a dissolved firm, by all persons (not being minors) who were partners in the firm immediately before its dissolution and by the legal representative of any such partner who is deceased.

(4) ....

(5) ....

(6) The application shall be made in the prescribed form and shall contain the prescribed particulars.

(7) Where registration is granted to any firm for any assessment year, it shall have effect for every subsequent assessment year:

Provided that--

(i) there is no change in the constitution of the firm or the shares of the partners as evidenced by the instrument of partnership on the basis of which the registration was granted; and

(ii) the firm furnishes, before the expiry of the time allowed under sub-section (1) or

sub-section (2) of Section 139 (whether fixed originally or on extension) for furnishing the return of income for such subsequent assessment year, a declaration to that effect, in the prescribed form and verified in the prescribed manner, so, however, that where the Income-tax Officer is satisfied that the firm was prevented by sufficient cause from furnishing the declaration within the time so allowed, he may allow the firm to furnish the declaration at any time before the assessment is made.

(8) Where any such change has taken place in the previous year the firm shall apply for fresh registration for the assessment year concerned in accordance with the provisions of this section."

A close reading of the aforesaid provision makes it clear that first requirement for registration is that an application of the registration of firm should be made in the prescribed form, which can be considered if the partner is evidenced by an instrument, the individual shares of the partners are specified in that instrument and it could be made either during the existence of the firm or after its dissolution.

Sub-section 7 envisages that where registration is granted or is deemed to have been granted to any firm for any assessment year, it continues for subsequent assessment years also subject to condition that there is no change in the constitution of the firm or the shares of the partners as evidenced by the instrument of Partnership which has formed the basis of granting registration and the firm furnishes within the time specified in the proviso the declaration to the effect that no change in the constitution has taken place during the year, nor there is change in the shares of the partners. At the same time it also envisages that where any change has taken place in the previous year, the firm must apply for fresh registration for the assessment year concerned in accordance with the provisions of the Act.

There is no dispute that in the onstitution of firm change had taken place by retirement of one of the partner durint the previous year relevant to assessment year 1976-77 and it duly applied under the aforesaid provision for fresh registration fulfilling all the

conditions of the provisions. In Section 185 the condition for grant of registration specified is that if the Assessing Officer is satisfied that there is or was in the previous year in existence a genuine firm with constitution so specified, he shall pass an order in writing to register the firm for the assessment year. It also provides converse provision that if he is not so satisfied, he shall pass an order in writing refusing to register the firm. Apart from this specific provision, Section 185 also deals with contingencies in which registration may not be granted. These are where the Assessing Officer considers that application for registration is not in order, he shall after giving opportunity to rectify the defect and if such defect is not rectified within specified time can refuse to register the firm and reject the application. Likewise, if the Assessing Officer considers a declaration required to be furnished by the firm for continuance of the registration under sub-section 7 of Sec. 184 is not in order, after intimating the assessee to rectify the defect in declaration within time specified in the notice and the same having been not removed, a declaration may be made that the registration was not continuing for the assessment year in question. It can also decline to grant registration in case there is any failure on the part of the assessee, as is mentioned in Section 144 that is to say, in complying with the requirement of notices, etc. and failure to such compliance would result in authorising the Assessing Officer to frame best judgement assessments.

Section 186 deals with cancellation of registration already granted. It speaks of only one ground on the basis of which registration can be cancelled -viz. where the Assessing Officer was of the opinion that during the previous year, no genuine firm was in existence as registered, he may after giving the firm a reasonable opportunity of being heard, cancel the registration of that firm for the assessment year.

From the aforesaid provisions, it is apparent that once procedural requirements are complied with about making of an application and furnishing of partnership deed etc. the only enquiry germane for consideration regarding question of registration is whether the firm which is seeking registration is genuine and existed during the previous year concerned. No other consideration enters for a scrutiny at the stage of grant of registration. The provisions in cases registration may be refused deals with the other grounds where requirement of procedure for making application has not

been properly fulfilled. In that event the application for registration or declaration of continuance of the firm may be rejected on the ground of the same being not in order after giving an opportunity to rectify the defects and the same remains to be removed. But subsequent to the grant of registration it can be recalled only on the ground, not on the basis of failure on the part of procedure but substantive ground, on finding that genuine firm was not in existence during the relevant assessment year. The aforesaid provisions which are the provisions in part B of Chapter XVI relating to registration of firms in their circumspect reading do not permit reconsideration of registration on the ground that subsequent to grant of registration there is any error in allotment of shares of the firm amongst the persons entitled to it in respect of a firm which is genuinely in existence. Obviously such step has not been thought fit to be taken into consideration by the statute to make part of the consideration for registration because the assessment of taxable income in the hands of the firm and allocation of profits amongst the partners after adjusting the allowable expenses or outgoings in the name of the partners for the purposes of assessment of the income of the partners individually in their hand is part of the assessment proceedings having relation to computation of income. Sections 187 and 188 which deals with changes in the constitution of the firm and succession and dissolution of the firm specifically deals with this part. Section 187 provides that where at the time of making an assessment under Sec. 143 or Section 144, it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time of making the assessment. This provision obviously applies at the time when actual assessment is taking place. It may be that at the time of actual assessment the firm as constituted during the relevant previous year of the assessment for which assessment is being made, may or may not be existing in the same form. If at the time of assessment the same firm is continuing to exist without there being a succession in its reconstituted form either by change in the partners or change in the ratio of profit sharing or both. Reconstitution of firm has been treated to be distinct from succession of the firm as we shall presently see with reference to the other provisions of the Act. The proviso which existed during the relevant assessment year to Section 187(1) required of the Assessing Officer that income of the previous year shall, for the purposes of inclusion in the total income of the partners, be apportioned between the partners who in such previous year were entitled to receive the same and that

when the tax assessed upon a partner cannot be recovered from him, it shall be recovered from the firm as constituted at the time of making the assessment.

The aforesaid provision makes it abundantly clear that firstly the question of apportionment of income of the firm amongst partners who were entitled to receive the same during the previous year in question arises for the purpose of including the same in the income of the partners personal assessment and secondly for the purpose of making it clear that though payment of tax on such share of the partner which is liable to be included in his own income continues to be primary responsibility of the partners concerned nonetheless if he fails to discharge his obligation to pay tax in respect of his income from the share in the firm of that period the firm continued to carry on business as reconstituted, such reconstituted firm as is in existence at the time of assessment becomes responsible for making payment of that tax in that respect, notwithstanding that it may not be existing in that form during the relevant previous year assessment of which he is being formed. Section 188 envisages that where a firm carrying on a business or profession is succeeded by another firm, and the case is not one covered by Section 187 which we referred to above, separate assessments shall be made on the predecessor firm and the successor firm in accordance with the provisions of Section 170.

These two provisions read together leave no room of doubt that reconstitution of the firm is quite distinct from succession of firm for the purposes of Income Tax Act. In the former, there is no break in the continued existence of the firm as an entity, but with the change of partners or change in ratio of profit sharing or change in both and in latter case on occurrence of such change the existing firm comes to an end and stands dissolved and question of succession becomes relevant. If new firm came into existence, it comes into existences severing its connection with the past firm. We are not presently concerned in what cases changes can be considered as reconstitution and in what cases changes would result in succession as that is not germane for the present discussion.

However, the aforesaid provision also makes it clear that allocation of the shares to the persons/partners entitled to receive the same in the previous year in question is an obligation cast on the Assessing Officer while framing assessment of the relevant assessment year, but is not an obligation cast

on the assessee for the purposes of seeking registration of the firm nor it is a part of any relevant consideration for considering the question of grant of registration or cancellation of registration. The fact remains that so far as compliance with the procedural requirement of submission of forms or documents are concerned, there is no dispute that the assessee has complied with the same. His application was found in order and it was liable to be considered in terms of Section 185. The Income Tax Officer under Section 185 has recorded in unequivocal terms that during the previous year a genuine firm was in existence. That finding has not been found to be erroneous either by the Commissioner in any respect. The only breach of condition which the Commissioner has referred to in his order is of proviso (1) to Section 187 as it existed during the relevant assessment year and has been referred hereinabove. We have found that, that provision has relation to the assessment subsequent to the grant of registration and is a part of obligation of the Assessing Officer to find out for the purposes of facilitating the assessment of the partners to allocate and apportion the income of the firm amongst the partners in the previous year who were entitled to receive the same. This has to be read in the context of the provision which requires that in the case there is a change in the constitution of the firm at the time when assessment is being made, the assessment has to be made on the reconstituted firm. Obviously in such event though the assessment is against the reconstituted firm, assessment of period during which the firm existed in its earlier form may be having different partners and different profit sharing ratio. Since the assessment is of the income of the previous year though in the hands of the same entity constituted by different persons or in a different ratio, the computation of income must confine to the existing realities during the previous year relevant to the assessment year for which income is being assessed with reference to law in force during the relevant assessment year. It is to give effect to the object of maintaining the continuity of the assessable unit and uniformity and determining the liability of those persons who have actually earned the income and liable to pay tax during the assessment year in question that the provision has been enacted but it has no relation about the question of genuineness of the firm which alone is the relevant consideration for the purpose of finding that the registration has been granted erroneously or rightly.

The conclusion to which we reach irresistibly is that on the facts found by the Commissioner of Income Tax

as affirmed by the Tribunal, registration of the firm could not have been cancelled in law. The correctness of that finding whether the retiring partner was entitled to a share in the profit of the firm on the date of his retirement which dependent upon the premises of the agreement and application of the ratio in Ashok Chimanbhai's case may have bearing on the question whether the assessment of the firm which was registered was erroneous or prejudicial to the interest of the Revenue or not, but since that controversy has not been raised before us with reference to the assessment and is not required for the present purposes, we do not examine the correctness of that finding.

In view of our discussion above, we answer the question as reframed by us in the negative - that is to say in favour of the assessee and against the Revenue. Reference stands disposed of accordingly with no order as to costs.
